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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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| | |
|---|---|
| IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN. | Docket No. E-01345A-08-0172 |

**NOTICE OF FILING**

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Reply Testimony of Jodi A. Jerich, Director of RUCO in support of the Settlement Agreement in the above-referenced matter.

RESPECTFULLY SUBMITTED this 13th day of August, 2009

Daniel W. Pozefsky
Chief Counsel

Arizona Corporation Commission
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of August, 2009 with:

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ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-08-0172

# REPLY TESTIMONY
# IN SUPPORT OF SETTLEMENT AGREEMENT

OF

JODI A. JERICH, DIRECTOR

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

AUGUST 13, 2009

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**INTRODUCTION**

**Q. Did you file testimony in support of the proposed APS Settlement?**

A. Yes.

**Q. What is the purpose of your reply testimony?**

A. The purpose of my testimony is to reaffirm RUCO's position regarding the APS line extension policy established by the Corporation Commission and to address the Direct Testimony in Opposition to the Proposed Settlement.

**Q. Have you read the testimony opposing the settlement including the Fiscal Impact Study completed by Elliot Pollack & Company?**

A. Yes, I have read the testimony. I also attended the depositions of Rick Merritt and Daniel Court who conducted the Study on behalf of the Company. Additionally, I reviewed the transcripts of those depositions. Members of RUCO staff attended the public comment sessions held in Flagstaff and Prescott where a number of residents voiced their opinions regarding the line extension policy.

**Q. Briefly summarize RUCO's position on the line extension policy proposed in the Settlement Agreement.**

A. As I mentioned in my Direct Testimony in Support of the Proposed Settlement Agreement, 20 parties, including RUCO, have committed their support for the proposed Settlement Agreement. That Settlement Agreement preserves the line extension policy established by the Commission in the 2007 APS rate case. Since that previous APS rate case, the Commission has also instituted that same line extension policy to other electric utilities, such as TEP. In an effort to address concerns and confusion about this change in policy, the Settlement requires APS to do a better job in informing its customers about the itemized costs of line extensions. Furthermore, the Settlement requires APS to inform customers that they have the option of "sub-contracting" some non-electrical work (such as trenching) to a vendor other than APS.

Four of the five Commissioners have filed letters in this docket on this issue. Clearly, there is an interest in re-examining the line extension policy. As stated in my direct testimony, RUCO recognizes that the Commission may find it appropriate to return to some version of the previous free footage allocation for individual landowners. In that direct testimony (pp. 24-25), I noted that any change should not go beyond the previous 1,000 feet/$25,000 policy and that any change should have as little of an impact on ratepayers as possible. There is nothing free about a "free footage" allowance. Furthermore, if the Commission finds a reversal of policy compelling due to current economic conditions, then it would be appropriate for this change in policy to remain in effect only for a temporary period of time in recognition of the unique economic times the State and its residents currently face. At the conclusion of that period of time, there will be sufficient evidence to see if the change has had a positive, quantifiable impact on property values and land development compared to the 2007-2009 time period when there was no free footage allowance in the APS service territory.[1]

**Q. Are you aware of the Commission's decisions to hold a series of workshops on the issue of free footage allowances in line extension policies?**

A. Yes. RUCO understands that in a recent staff meeting the Commissioners directed Commission Staff to set up a series of workshops to reexamine this issue. RUCO supports the Commission's action and believes ***if a new policy is adopted, it should be fair not only to landowners, but also to the ratepayers who will pay for any "free" footage.***

**Q. Briefly summarize the testimony in opposition to the proposed settlement agreement.**

A. Several real estate agents and land developers filed testimony in opposition to the current line extension policy. The witnesses provided examples of situations where landowners cannot afford to pay for the line extension to their undeveloped parcel of land. For at least two of the examples, it is apparent that their line extensions would have fallen within the 1,000 foot/$25,000 feet limit (Testimony of Ian Campbell, p. 1 and Debra Morrow, p.

[1] In footnote 5 of my direct testimony, I noted that according to information filed by APS on June 25, 2009, if the Commission were to adopt a modified 500 feet/$10,000 free footage allowance, the financial impact is estimated to be $2.76 million in 2010, $3.14 million in 2011 and $4.55 million in 2012. If the Commission were to shift the cost burden from the individual landowner to other ratepayers, the average residential ratepayer would see an increase in their monthly bill of approximately $0.11 in 2010, $0.13 in 2011 and $0.18 in 2012 as a result of this policy change.

1). It is unclear whether the other examples provided would have benefitted from the previous policy since the previous policy held that if an extension exceeded $25,000 then the landowner paid the entire cost of the extension – not merely the costs that exceed $25,000.

The testimony filed in opposition to the current policy as well as the comments expressed at the public comment meetings make it obviously clear that the 2007 change in the policy has resulted in certain individual landowners not being able to afford to bear the costs of providing electricity to their land. RUCO recognizes that this anecdotal testimony may provide some indication of the impact of the change in the policy. However, consideration of any negative impact that this policy may have for certain individual landowners should not be the only factor considered in evaluating the public interest. It is important to weigh the impact on landowners against the benefit of maintaining lower electric rates for the vast majority of ratepayers.

The sentiment of all those who filed testimony in opposition to the current line extension policy can best be summed up through the testimony of Chad Fisher:

> "I support a free footage allowance of 1,000 ft with a $25,000 cap, which is the same line extension policy that was in place prior to July 2007. It is my understanding that any changes to service schedule 3 must remain revenue neutral. The testimony of David Rumolo states that estimated impact of returning to the prior service agreement of 1,000 ft free (if under $25,000) to be

> $5,950,000 in 2010 and increased to $10,000,000 in 2012. Also in his testimony he stated that in order to remain revenue neutral, APS estimates that each $5,000,000 of reduced schedule 3 revenues would require an additional rate increase of roughly $.20 per month." (Fisher at p. 1)

**Q. Does the Impact Study that was filed with the testimony alter RUCO's position?**

A. No. For the most part, the Study is not focused on the critical issues that need to be evaluated in deciding who should pay for a line extension.

- Is it in the broad public interest for all APS ratepayers to pay for the costs to individual parcels for a small number of landowners?
- Alternatively, is it a better policy to keep rates as low as possible for all ratepayers and have these costs borne by those who directly benefit from the line extension?
- Do the consequential benefits of developed land--arguably higher property values and better resale prices for undeveloped land--provide enough of a general, societal benefit to warrant the subsidization of individual line extensions by having all ratepayers pick up the costs for qualifying extensions?

The Study provides little consideration to these important public policy considerations. While RUCO sympathizes with the individual landowners who are affected by the 2007 elimination of the free footage allowance, RUCO believes that the benefit of maintaining lower electric rates for the majority of the ratepayers outweighs the interests of a few. For this reason, RUCO supports the provision in the Settlement Agreement that maintains the current line extension policy.

While the Study comes to the conclusion that the change in the line extension policy may negatively impact land values (Study at p. i), there is no quantifiable data presented to show the amount of the impact. Furthermore, there is nothing in the Study that distinguishes the impact the economic recession and the fallout of the real estate market have had on property values in comparison to the change in the line extension policy.

The Study itself states:

> "It is unclear the extent that any increase in the cost of energy and electrical infrastructure will impact builders' and businesses' perceptions about Arizona. It is also not clear the extent to which these perceptions will result in slower economic growth, fewer business expansions, or less homebuilding activity in the State...There is no way of knowing with complete certainty the extent to which the increased capital costs of extending power to a given site will result in fewer homes being built over the long run. Therefore, it is not possible to provide specific estimates of economic losses as a result of this new policy." (pp. 23-24)

Rick Merritt's deposition further illuminated the lack of correlation between the line extension policy and land values.

> "A. ...We did not conduct any analysis of land values or the potential impact of the service schedule, the changed Service Schedule 3 on the value of land.
>
> Q. You did not analyze the potential impact of Service Schedule 3 on the value of land?
> A. Correct.
>
> Q. Your study is thus not intended to present evidence that the change in line extension policies actually caused the economic impact you described in section 5 of your report?
> A. Correct...

> Q. Do I take it then that your study is not intended to present evidence that the change in line extension policies actually caused the impacts described in section 5?
> A. Our analysis says that there is not enough information available to determine what the impact would be of Service Schedule 3. But for every 100 homes that may not be built in this, in the APS service area or other service areas, there is a particular impact on jobs and revenue that would be developed and generated to cities, state, counties.
>
> Q. Do you have any evidence that 100 homes will not be built as a result of the changes to Service Schedule 3?
> A. No, we do not.
>
> Q. Do you have any evidence that 10 homes will not be built as a result of the change to Service Schedule 3?
> A. No, we do not."

While the Study does not provide concrete and quantifiable data on the financial impact of the change to the line extension policy, it does reflect the same sentiment expressed by those who filed testimony, the authors of several letters filed in this docket and the ratepayers who have attended the public comment meetings.

> "More than anything, the elimination of the no cost extension and other policies that helped to subsidize growth by these electric utility providers is an issue of *fairness*." (Study at p. 35).

As discussed in the Study and voiced at the public comment meetings, some landowners feel trapped in their undeveloped lots due to increased costs of construction that resulted with the 2007 policy change. Realtors and developers whose ability to earn a living has been severely restricted due to the economy feel that their troubles have only been magnified by the 2007 policy. Homebuilders who are looking for any advantage they can find to keep their business doors open are seeking every opportunity to make it more affordable to build homes. The statistical data might be lacking, but the emotional tug of this issue is clear.

**Q. Is there more to be considered in deciding whether the line extension policy should be changed again?**

A. This Settlement Agreement is just like any other settlement in that it consists of numerous concessions, compromises and negotiated positions. For example, one provision of the Settlement may be directly linked to another provision and amending that one provision impacts the other. Such is the case with the issue of the line extension policy. In an effort to minimize the amount of the rate increase but still give APS sufficient operating revenues to construct a healthy ROE, improve its credit ratings and enhance its FFO/Debt ratio, the parties to the Settlement agreed that proceeds from Schedule 3 (line extensions) would be treated as revenue for the next few years (Section X). Currently, Schedule 3 proceeds are treated as Contributions in Aid of Construction.

...

...

**Q. If the Commission decides to revise the line extension policy in this rate case to include some sort of equipment allowance or free footage allowance, how would that decision impact other components of the Settlement Agreement?**

A. Treatment of Schedule 3 proceeds as revenue is a material provision of the Settlement Agreement. APS estimates Schedule 3 revenues to be $23 million in 2010, $25 million in 2011 and $49 million in 2012. These sums were a significant consideration in reaching an agreement on the revenue requirement and overall magnitude of the rate increase. Without this treatment of Schedule 3 proceeds, there was very little chance that the parties could have come to a mutually acceptable agreement on the size of the revenue increase. To further complicate the consideration of altering the existing line extension policy, Section X of the Settlement Agreement is directly linked to Section II. Section II prevents new base rates until at least July 1, 2012. Section II is particularly important to RUCO. Without sufficient revenue in years 2010, 2011 and 2012, APS would not be able to "stay out" for 2 ½ years without another rate case application. After a continuous string a rate cases, RUCO believes that the ratepayer deserves a break from increasing utility bills.

If the Commission does decide to alter the line extension policy to allow for some form of free footage or equipment allowance, it should recognize economic realities and find a viable alternative way to pay for these costs. If the Commission does not allow the Company to recover the costs associated with a free footage allowance, the results will not be in the best interests of the residential ratepayer for three closely related, very important reasons.

First, if the Commission does not allow the Company to recover the expenses associated with line extensions in base rates or some other form of recovery, then the Company will pay for the costs of these line extensions from investor-provided capital. Typically, capital assets that are paid for in this manner will enter the rate base and the Company will receive a rate of return on these capital assets as well as reimbursement of the cost through the depreciation process. Over the long haul, this treatment will burden other ratepayers by substantially more than $0.20 per month (as mentioned earlier in my testimony) which is calculated based on immediate cost recovery.

Second, if the Settlement is rejected and a protracted and litigated rate case becomes necessary, it could produce detrimental consequences for APS ***and its ratepayers*** on Wall Street. It is certain that APS' credit ratings would not be upgraded and they may possibly be downgraded while the case is pending. This would affect APS' ability to borrow money at reasonable rates and even hamper its ability to attract investors to infuse equity into its capital structure (See RUCO direct testimony, Johnson at pp. 18-28, Jerich at pp.9-11). The Settlement Agreement requires APS to maintain investment grade ratios and to strengthen its capital structure with no more than 52% debt/total capital, as well as a commitment to invest at least $700 million of equity into the Company (Section VIII). RUCO fought hard for these very important provisions. A change in the line extension policy without a corresponding increase in revenue could lead to the collapse of the Settlement Agreement. If this happens, a ratings downgrade may make it difficult – if not impossible – for APS to make the required improvements to its financial health as set forth in the Settlement Agreement. (Johnson Direct Testimony pp. 28-29).[2]

Third, it is possible that one or more parties may withdraw from the Settlement Agreement because of the material change to the revenue agreement. Such action would result in a protracted, litigated rate case with the potential for appeal. Unraveling the Agreement would bring about a cascade of other consequences. With this Settlement Agreement, the Commission has a great opportunity to bring important and far reaching energy efficiency and renewable energy goals to Arizona. While some of these measures are being contemplated in the energy efficiency workshop, the cost recovery mechanism in the Settlement Agreement is more ratepayer friendly then the options being proposed in the workshop. Furthermore, while the Commission may decide to increase RES minimum requirements, the Commission has the opportunity to bind APS to higher goals ***now*** through the Settlement Agreement. Finally, if the Commissioners want to adopt some

[2] APS noted that upon announcement of the Settlement Agreement, Pinnacle West's outlook was upgraded from "Neutral" to "Outperform". (See Hatfield Direct at p.9). It is logical that if reaching a settlement was beneficial, then the unraveling of the settlement would have a corresponding negative impact.

sort of free footage allowance in the APS line extension policy in this case, then that decision can be placed in effect sooner if the changes are effectuated in a manner that allows the Settlement Agreement to remain intact, thereby achieving a resolution to the rate case without lengthy (and appealable) litigation.

**Q. Does this conclude your testimony?**

A. Yes.